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**USWEST**

April 15, 1993


Ms. Donna Searcy
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Stop Code 1170
Washington, DC 20544

Subject: <u>CC Docket No. 92-24, LIDB Tariff Investigation</u>

Dear Ms. Searcy:

U S WEST Communications (USWC) herein responds to queries from
Dr. Chris Frentrup in matters pertaining to the above-referenced proceeding.
Specifically, USWC takes this opportunity to further clarify and explain the
methodology used to calculate direct cost factors. USWC's factors utilize
economic cost causative relationships to investments and costs which in many
cases are specific to the particular product or service being studied.

USWC has grave concerns with the staff's attempts to use ARMIS-based data
to benchmark direct cost factors. ARMIS is reflective of historic, embedded
costs. It is a representation of service cost and equipment mix by broad
categories. The methodology utilized by USWC incorporates a forward-
looking incremental approach. Whereas an ARMIS-based methodology
develops factors on a broad and generalized basis, USWC's methodology
provides a precise loading of direct costs for each specific service. LIDB (or
any other USWC product) may or may not reflect the same mix of equipment
as that reflected in historic ARMIS reports. However, USWC's use of data
specific to the *exact* equipment mix of a product will always result in a more
precise calculation of direct costs and expenses. Any similarity to factors
developed from ARMIS data is, therefore, purely coincidental.

The attached narrative provides a detailed explanation of the methodology
employed in the development of direct cost factors for the LIDB Validation
rate element. This methodology is applied to other USWC products and

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services in the same manner. The factors are applied to the unit investment or an additive of other cost/expense elements for the specific product or service to obtain the direct expense. These "loadings" are then added to the unit investment to arrive at the total direct cost. Appendix A shows each factor for LIDB Validation as it is applied to each cost or expense category to derive the cost loading.

Acknowledgment and date of receipt of this transmittal are requested. A duplicate letter is attached for this purpose.

If you have any quesstions, please call the undersigned.

Sincerely,

Attachments

cc:    Mr. Greg Vogt
       Ms. Mary Brown
       Mr. Mark Uretsky
       Dr. Chris Frentrup
       Ms. Judy Argentieri

**ISSUE:** Are the expense loading and direct cost factors use by U S WEST in the Line Information Database (LIDB) tariff filing reasonable and consistent?

As shown in the analysis following, expense and cost factors used by U S West are reasonable and consistent. The methodology used to calculate the factors used in U S WEST's analysis is based on economic cost causative relationships and is applied consistently in both state and federal jurisdictions by U S West. Further, the underlying source of the projected expense factor information is verifiable U S West financial information and provides an appropriate and reasonable base on which to project LIDB expense and direct cost factors.

### General Methodology for Annual Cost Factors

The annual or recurring costs calculated represent the expected yearly expenses resulting from the investment used to provide the service. There are two types of factors used to develop annual costs. The first, referred to as annual capital costs, includes depreciation, cost of money (labeled earnings in U S WEST's cost work papers) and income tax. The second type, referred to as operating expenses, includes maintenance expense, ad valorem, administrative overheads, and business fees.
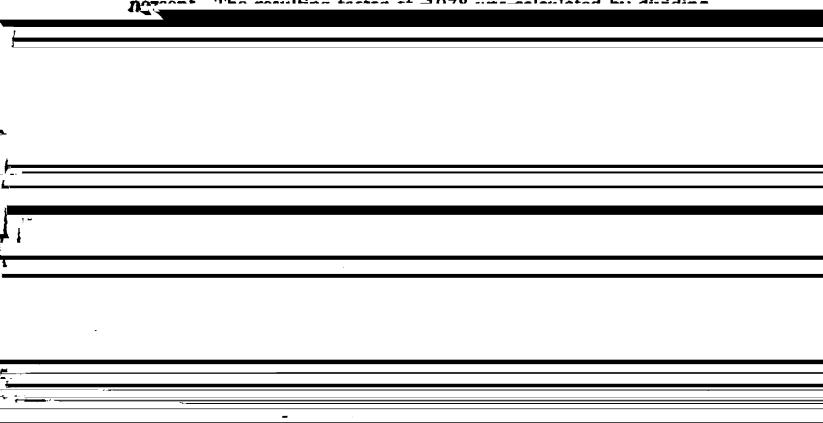
*Capital Cost Factors*

*Depreciation*  Two types of depreciation are involved in the determination of recurring capital costs - book depreciation and tax depreciation.

Book depreciation is the repayment of invested capital and is a direct component of capital costs. Book depreciation amounts are determined by: (1) total investment, less net salvage value, in assets; and (2) estimated life characteristics. The life characteristics are projection life and survivor curve shape that are anticipated at U S WEST Communications.

Tax depreciation is analyzed because of its effect on income taxes. Tax depreciation is calculated separately from book depreciation because amounts and timing will differ from book depreciation. This occurs because income tax regulations often permit using accelerated tax depreciation on new investments. With accelerated depreciation, tax depreciation expenses are greater during the earlier years of an asset's life. Although, not a component of recurring capital costs, tax depreciation impacts capital costs through the income tax component.

The depreciation component of the capital costs of the services reflects an economic life of 5.1 years and a net salvage value of two percent. The resulting factor of .1978 was calculated by dividing

*Income Tax Expense*  Along with capital repayment and return, income taxes are incurred on the return required for the equity portion of the capital. Income taxes are involved because federal and state regulations provide for taxing remaining income after payment of operations costs and other deductible amounts. These income taxes are then a portion of the revenue required to meet the capital costs of the undertaking.

For example, in Appendix A, the tax rate was calculated using a state income tax rate of 5.25% and a federal income tax rate of 34%, resulting in a composite rate of 37.47%. The resulting income tax factor is .0235, which is calculated by dividing the levelized income tax expense by total investment.

## Operating Expenses

*Maintenance Expense*  The maintenance expense included in the LIDB cost analysis is not based on a maintenance factor but rather based on estimates of work functions, work times and contract costs associated with daily updates of the LIDB database.
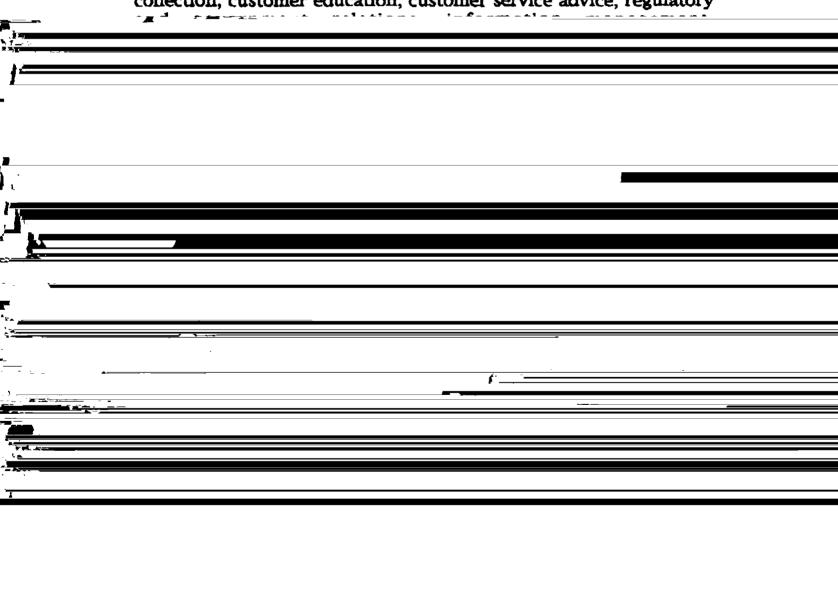
The maintenance included in the LIDB Validation cost component represents the monthly maintenance fee from the software vendor to extract data from the daily service order flow system. The extract is use to feed daily calling card and other related updates into the DBAS system. This interface is supplied and supported by an outside vendor. These calculated costs are then multiplied by the appropriate administrative and business fee factors discussed following. These maintenance costs are verifiable from the contracts with the vendor. The resulting cost is $.000927 per query.

The maintenance included in the LIDB Validation DBAC Expense represents the labor related expense in maintaining the DBAC database. These labor related costs include direct occupational wage and salary, direct supervision, overtime, paid absence, training, social security taxes, relief and pensions, and other administrative clerical related employee costs.

This labor cost is calculated by multiplying DBAS supervisor provided headcount by expected labor rates for the functions performed. This identified labor costs identified is then multiplied by the Administrative and Business Fee Factors discussed below.

*Ad Valorem Tax Factor* The ad valorem tax factor represents the relationship between ad valorem and other taxes and investment. The source data for the factor is general ledger account information. The factor is calculated by dividing property tax (Account 7240.11) and other taxes (Account 7240.99) by total current investment. The ad valorem tax factor used in the studies is .0119. Appendix A provides an example of how this factor is used in the LIDB study.

*Administrative Expense Factor* The administrative expense factor identifies general expenses which vary in proportion to direct expenses and which are not quantified as distinct direct expenses. Examples include product management expense, non-product specific sales expenses, customer accounting expenses except for billing and collection, customer education, customer service advice, regulatory

## LIDB VALIDATION DIRECT COST LOADINGS
### (excluding DBAC expense)

|  | Annual Factor | Recurring Cost |
|---|---|---|
| A. Total Unit Investment | n/a | 0.019072 |
|  |  |  |
| B. Capital Costs |  |  |
|    1. Depreciation | 0.1978 | 0.003770[1] |
|    2. Cost of Money (Earnings) | 0.0574 | 0.001093[1] |
|    3. Income Tax | 0.0235 | 0.000452[1] |
|  |  |  |
| C. Operating Expenses |  |  |
|    1. Maintenance | n/a | 0.000927[2] |
|    2. Ad Valorem | 0.0119 | 0.000235[1] |
|    3. Admin. Overheads | 0.0846 | 0.000531[3] |
|    4. Business Fees | 0.0091 | 0.0000055[4] |
|  |  |  |
| Total Direct Unit Cost | n/a | 0.007063 |

*The minor discrepancies found in a few of these calculations are due to jurisdictional and account